

Advisor *Info*

Investment

Systematic Investment **...or painless saving is possible**

- TIME IS OF THE ESSENCE
- MUTUAL FUNDS ARE IDEAL
- SLEEP TIGHT

One of the unfortunate consequences of a market meltdown like we are going through is that it tends to scare investors away from equities – the very asset class that is efficient to grow the purchasing power of their savings in real terms after the taxation and inflation have been factored in. The irony is that this happens at the very time when stocks are at their cheapest and opportunity at its greatest!

It all comes down to the question of “When is the right time to invest?”. People have been asking themselves this question since the birth of investing, and there is not only one valid answer. Of course, fundamental analysis can give us an indication of when a security is selling for less than it’s worth and vice versa, but study after study concludes market timing (making whole scale swings into and out of the market in order to “buy low and sell high”) is impossible to do with the consistency required to make such a strategy worthwhile. Bottom line – the right time to invest is whenever you have the discretionary cash available to do so.

The systematic investment plans makes saving the actual money to invest a lot easier, removes any consideration about the “right” time to invest, and thanks to dollar cost averaging, reduces the angst related to market volatility.

Systematic investment

Putting money aside in a regular savings account is better than nothing, but it is unlikely that the interest you earn will buy much in the way of a retirement. You could also let the money accumulate in a savings account and, once a year, use it to purchase a GIC or term deposit. This is certainly better than the option mentioned above, but still far from ideal. Throughout the year, your money accumulating in the savings account is not deployed very productively, and given today’s low interest rates, even the Guaranteed Investment Certificates (GICs) you purchase once a year are not growing your capital effectively after the impact of taxation and inflation are considered.

With mutual funds¹, the money debited from your bank account is invested in the fund or funds of your choice. Thanks to mutual funds’ small minimum investment requirements, your savings can be immediately invested into the specific asset classes you wish to hold for the long term – you don’t have to park small amounts unproductively in order to accumulate the minimum investment needed for many types of vehicle – often between \$500 and \$1,000. Furthermore, you can choose the mutual fund or funds to purchase based on your investor profile, being as conservative or aggressive as desired. And you can set up a systematic plan with as little as \$25 per periodic investment.

Finally, by investing a fixed amount once or twice a month, you never have to worry about whether you have chosen the “right” time to invest – you are effectively investing on a continual basis. This works particularly well with funds that invest in more volatile asset classes like common stocks. If markets should temporarily head downward, falling unit prices simply mean that your fixed amount buys more units with each investment. Then when markets do bounce back, as they inevitably do, you have the leverage of enjoying a price increase on a larger number of units.

Periodic savings

Putting your fears about the current state of the market aside, and salting money away on a regular basis can be a lot easier than you think. With any “New Year’s resolution” taking the first step is usually the hardest part, and saving is no different. Whether it be for a specific project or for retirement, a systematic investment plans is the most painless to save.

With a periodic savings plan, a fixed amount is automatically deducted from your bank account at a set frequency. The beauty of the periodic savings plan is that at the end of the calendar year, you will have saved a substantial amount in total even if the amount taken off each period is fairly small.

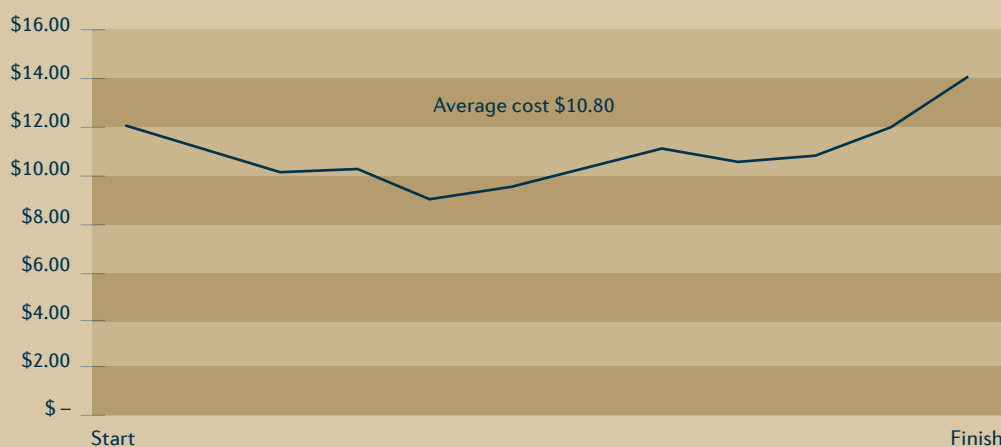
¹ Commissions, trailing commissions, management fees and expenses all may be associated with mutual fund investments. Please read the prospectus of the funds before investing. The funds securities are not insured by the Canada Deposit Insurance Corporation or by any other government deposit insurer. The funds are not guaranteed, their values change frequently and past performance may not be repeated.

Systematic investing – three examples

We've seen how the automatic nature of a systematic plan makes it easier to set money aside, and how using mutual funds allows you to put small periodic sums to work productively for you in the asset class of your choice. But is this way of building wealth effective from an investment perspective? We will compare it to the traditional way of investing a lump sum under three different market scenarios².

SCENARIO 1 – THE MARKET FALLS, AND THEN REBOUNDS

Individual A invests a lump sum of \$5,200 at the beginning of the year in a growth fund, whereas Individual B uses a systematic plan to invest \$200 every two weeks in the same fund, for a total of \$5,200 at the end of the year. The unit value of the fund falls from \$12 at the beginning of the year to \$9, and then rebounds to \$14 by year-end.



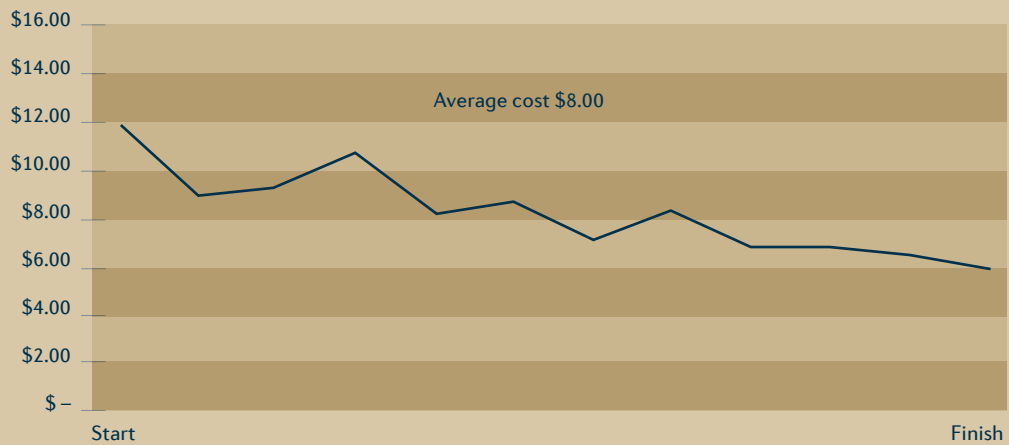
	Individual B Systematic Purchase	Individual A Unique Purchase (Beginning of period)
Total Investment	\$5,200 (\$200 X 26)	\$5,200
Average Cost	\$10.80	\$12.00
Unit Purchased	481	433
Market Value	\$6,734	\$6,062
Advantage	\$672.00	

As we can see, under this scenario, the systematic plan comes out ahead by over \$600, or more than 10%. Why? Because as the market declines, the fixed periodic investment purchases more units, and as a result, Individual B ends up owning more units at year-end than Individual A, with a lower average cost. Systematic investment plans work well in conditions where markets fall, and then rebound.

² The data presented in the following charts is based solely on hypotheses. The calculations are provided for informational purposes only, and only serve to illustrate the effects of systematic investments over the investment period under identical conditions. The actual returns of your investments may be higher or lower than the hypothesis presented, namely according to the nature of the securities in which you will have invested and the timing of your investment(s). The data presented does not create any legal or contractual obligations for National Bank of Canada or any of its subsidiaries.

SCENARIO 2 – THE MARKET FALLS

Let us consider a scenario that reflects the latter half of 2008 – one under which the market, as well as the unit value of the fund under consideration falls by 50%. We once again compare the lot if Individual A, who commits the \$5,200 lump sum at the beginning of the year to Individual B, who sets \$200 aside 26 times during the year.

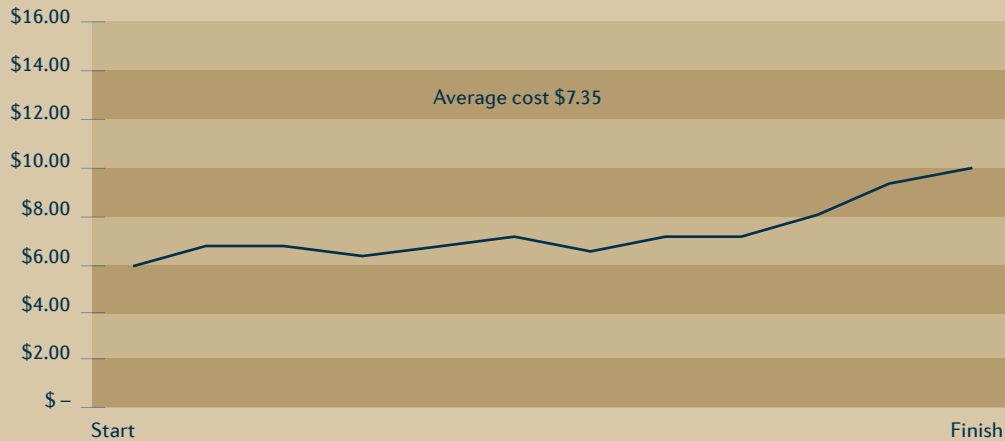


	Individual B Systematic Purchase	Individual A Unique Purchase (Beginning of period)
Total Investment	\$5,200 (\$200 X 26)	\$5,200
Average Cost	\$8.00	\$12.00
Unit Purchased	650	433
Market Value	\$3,900	\$2,598
Advantage	\$1,302	

While both individuals have a paper loss at the end of the year, we see that the systematic investment plan has again come out ahead, and by a considerable margin. Individual A experienced the impact of the 50% loss on the full \$5,200 lump sum, whereas by investing regularly throughout the year, Individual B ends up owning more units, and has a lower average cost base. In this case, the systematic investment plan has done a good job of tempering market volatility.

SCENARIO 3 – A STEADILY RISING MARKET

Let's compare the same two investment strategies under a more positive scenario – one where the market rises, pushing the unit value of the chosen mutual fund up from \$6.00 to \$10.00.



	Individual B Systematic Purchase	Individual A Unique Purchase (Beginning of period)
Total Investment	\$5,200 (\$200 X 26)	\$5,200
Average Cost	\$7.35	\$6.00
Unit Purchased	708	866
Market Value	\$7,080	\$8,660
Advantage		\$1,580

Here we see that the lump sum investment is clearly the winning approach. With more money invested at the outset, Individual A ends up owning more units with a lower average cost than Individual B who, by making periodic investments in a rising market, ends up paying more for the units and therefore owning less of them.

Systematic investment plans in application

Markets tend to rise over the long term, so you would typically end up with a greater accumulation by investing a lump sum, and leaving it there for time to work its magic. However, this rule of thumb only works if you have the lump sum available, and possess the fortitude to remain invested throughout the inevitable bumps encountered along the way. Systematic investing not only makes it a lot easier to actually set money aside, it also helps you manage the emotional component of investing – which is what usually makes the difference between a successful experience and one that is disappointing. Finally, the strategy of regularly investing fixed sums does a very good job of tempering the volatility that characterizes common stocks and equity funds.

Enjoy your tax refund today!

Rather than making an RRSP contribution and then waiting anywhere between 3 and 18 months to receive your tax refund (assuming you are eligible for one), you can use the systematic investment plan to contribute directly to your RRSP, and enjoy your tax refund immediately. You can have the amount of tax deducted at source reduced each pay period reduced to reflect the fact that you are taking part of your salary and using it to make regular RRSP contributions. For instance, if you are in the 40% marginal tax bracket, a \$100 contribution to your RRSP will only reduce your cash flow by \$60, since \$40 less in taxes will be withheld at source from your pay cheque. The process is essentially the same as with a regular systematic plan – the amount you wish to save is debited from your bank account at the frequency of your choice, and these period amounts are used to purchase the fund or funds of your choice as an RRSP investment.

To do this you must fill Canada Revenue Agency form T1213 (plus form TP-1016 for Quebec taxpayers). Once you have received government approval, submit the paperwork to your employer, who will make the required adjustments to its tax withholding calculations.

Conclusion

- Periodic savings is easier and requires much less discipline;
- With the systematic investment, the fear of choosing the wrong time to invest is eliminated. On this subject, Sir John Templeton was fond of saying “The best time to invest is when you have the money to do so”.
- With a systematic investment plan, volatility can be tempered, since your periodic investments buy more fund units as markets decline. Over the long term, this allows you to reduce the average cost of your investment, and ultimately reap more profit when you sell it.
- Mutual funds are an excellent vehicle for implementing a systematic investment plan, since they represent the only way of investing small periodic amounts in the asset class of your choice, all when enjoying the benefits of diversification and professional management.

As you've seen in this leaflet, it is possible to save or invest even in difficult times. At National Bank Financial Group, our advisors can propose investment solutions suited to your needs. Contact us.

Useful Links:

Market volatility:

<http://www.bnc.ca/bnc/files/bnc10142/en/2/index.html>

CRA - T1213 for a Reduction in Source Deductions of Income Tax:

<http://www.cra-arc.gc.ca/E/pg/tf/t1213/>

Quebec - TP 1016 for a Reduction in Source Deductions of Income Tax:

<http://www.revenu.gouv.qc.ca/eng/formulaires/tp/tp-1016-v.asp>

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